

Message Text

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ACTION ARA-06

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FM AMEMBASSY LIMA

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C O N F I D E N T I A L LIMA 8874

LIMDIS

FOR DELIVERY OPENING OF BUSINESS SATURDAY MORNING

FOR ARA - WILLIAM ROGERS; L - MONROE LEIGH; EB - THOMAS ENDERS;
TREASURY - JOHN BUSHNELL; COMMERCE - DON ARRILL; CIEP - WAYNE
SHARPE

E.O. 11652: GDS

TAGS: EINV, EIND, PFOR, PE

SUBJ: MARCONA - FRIDAY MEETING WITH GOP COMMISSION

1. SUMMARY: AMBASSADOR AND US TEAM MET WITH PERUVIAN
COMMISSION FOR ONE AND A HALF HOURS FOLLOWING LUNCHEON AT RESI-
DENCE FRIDAY NOON. SESSION WAS DEVOTED TO DETAILED ILLUSTRATIONS OF U.S. VALUATION ALTERNATIVES (BASED ON CURRENT VALUE AND REPLACEMENT VALUE METHODS) THAT PRODUCE A FIGURE OF ABOUT \$120 MILLION. COMMISSION QUESTIONED CERTAIN ASPECTS OF PROPOSALS. SIGNIFICANTLY, THEY DID NOT TRY TO TURN DISCUSSION BACK TO BOOK VALUE, AND UNDERSTOOD THE POINT--THAT WE DID NOT VIEW THEIR FIGURES AS IN THE BALLPARK. END SUMMARY.

2. PROFESSOR FISHLOW (COMPLETE WITH BLACKBOARD) BEGAN HIS
LECTURE BY NOTING THAT THERE ARE ALTERNATIVE BASES OF EVALUATION
WHICH ARE MORE ACCURATE AND THUS MORE ACCEPTABLE ROUTES TO FAIR
COMPENSATION THAN BOOK VALUE. HE NOTED BY WAY OF INTRODUCTION
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THAT GOP FIGURES WERE BASED ON LAW (DL 19,419) APPARENTLY NOT

PROPERLY APPLICABLE TO EXPROPRIATIONS IN MINING SECTOR. BOTH PRESENT VALUE AND REPLACEMENT VALUE APPROACH ARE WIDELY RECOGNIZED WITHIN THE U.S. GOVERNMENT AS HAVING THESE ADVANTAGES.

3. THE "PRESENT VALUE" APPROACH BEGINS WITH ESTIMATES OF FUTURE ORE SALES AND PROFITS. (MARCONA, FISHLOW NOTED, HAD ARRIVED AT A \$171-MILLION FIGURE.) HOWEVER, THE MARCONA FIGURE HAS A SHORTCOMING; IT DOES NOT TAKE INFLATION INTO ACCOUNT. FISHLOW'S FIGURES INCLUDED DISCOUNT FACTOR FOR A 9.5-PERCENT ANNUAL RATE OF INFLATION. THE RESULT IS A FIGURE OF \$116.5 MILLION, WHICH MUST BE AUGMENTED BY WORKING CAPITAL (\$2.3 MILLION) FOR A TOTAL OF \$118.8 MILLION. FISHLOW EMPHASIZED THAT THE PROCESS (A) TAKES INTO ACCOUNT THE PRODUCTIVE CAPACITY OF THE FIRM, (B) IS CONSISTENT WITH PERUVIAN LAW 18880, AND (C) IS GENERALLY CONSISTENT WITH U.S. PRACTICE.

4. IN CONTRAST, "REPLACEMENT VALUE" METHOD ASKS THE QUESTION: HOW MUCH IS THE PROPERTY WORTH NOW GIVEN CURRENT PRICES AND THE CONDITION OF THE EQUIPMENT? THE ADVANTAGE OVER THE PRESENT VALUE APPROACH IS THAT IT DOES NOT REQUIRE PROJECTIONS INTO THE FUTURE AND IS BASED ON HISTORICAL VALUES OBSERVABLE BY ANYONE. THE FIGURES HE USED FOR ILLUSTRATION WERE TAKEN FROM MARCONA'S JUNE 30 BALANCE SHEET, INCLUDING ALL CURRENT ASSETS (A TOTAL OF \$36.8 MILLION) EXCEPT THE DISPUTED TAX CLAIM, WITH FIXED ASSETS BASED ON THE 1971 ARTHUR D. LITTLE STUDY (\$131.8 MILLION). HE STRESSED THAT FOR PURPOSES OF ILLUSTRATION ONLY HE WAS REDUCING THIS FIGURE TO 49 PERCENT (FOLLOWING THE COMMISSION'S APPROACH TO MARCONA'S FIXED ASSETS) AND BY THE \$4.2 MILLION OWED TO OTHER MARCONA SUBSIDIARIES. THE TOTAL WAS INCREASED BY AN INFLATION FACTOR OF 35 PERCENT (BASED ON GOP FIGURES) OVER 1971, FOR A TOTAL OF \$119.7 MILLION. THIS, HE NOTED, WAS A MINIMUM ESTIMATE OF REPLACEMENT VALUE.

5. FROM THESE TWO ILLUSTRATIONS FISHLOW CONCLUDED THAT MARCONA IS A VERY VALUABLE, VIABLE ASSET TO PERU, AND THESE ILLUSTRATIONS ARE EXTREMELY CONSERVATIVE. HE EMPHASIZED THAT MOST OF THE ASSUMPTIONS USED WERE THE MOST FAVORABLE POSSIBLE FOR PERU (AS WITH THE 9.5 PERCENT RATE OF INFLATION IN THE PRESENT VALUE CALCULATIONS). THE USG, HE SAID, CAN ONLY BE

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SATISFIED WITH A SETTLEMENT THAT IS FAIR AND EQUITABLE TO MARCONA, AND RETURNS TO MARCONA SOME MEASURE OF ITS TRUE WORTH. WE HOPE THAT THESE ILLUSTRATIONS DEMONSTRATE OUR SINCERITY IN SEEKING A JUST SETTLEMENT.

6. DE LA PUENTE BEGAN BY REITERATING GOP COMMITMENT TO "JUST PRICE", BY WHICH HE MEANT BOOK-VALUE APPROACH, AND SAID HE WOULD HAVE PREFERRED THAT US GROUP DISCUSS COMMISSION'S PROPOSAL INSTEAD. BROUSSET, HOWEVER, ASKED SEVERAL QUESTIONS

ABOUT U.S. ILLUSTRATIONS WHICH WERE DISCUSSED FOR THE BALANCE OF THE SESSION. HE COMPLAINED THAT MARCONA'S PRESENT-VALUE FIGURES (BASED ON A SUBSTANTIAL INCREASE IN ORE PRICES) WERE SUBJECTIVE AND WERE NOT CONSISTENT WITH WHAT MARCONA OFFICIALS HAD TOLD GOP, I.E., THAT GOP WOULD NOT BE ABLE TO RENEGOTIATE LONG-TERM CONTRACTS BECAUSE DEMAND FOR ORE WAS INELASTIC. FISHLOW CONCEDED THAT THERE WAS SOME UNCERTAINTY IN FUTURE PROJECTIONS, BUT EMPHASIZED VALIDITY OF ASSUMPTION THAT PRICE WOULD RISE WITH CONTINUED WORLD INFLATION, AND THAT ENDING OF RECESSION WOULD PROBABLY CAUSE FURTHER INCREASE, AS WAS TRUE IN THE 1963-74 PERIOD.

7. BROUSSET ALSO ARGUED THAT WITH FOREIGN COMPANIES REPLACEMENT-COST FIGURES SHOULD TAKE INTO ACCOUNT REMITTED DEPRECIATION ACCOUNTS, AND OMIT UPWARD ADJUSTMENT FOR INFLATION OF ASSET COSTS. FISHLOW NOTED THAT INFLATION ADJUSTMENT ALSO INCREASES DEPRECIATION CHARGED AGAINST THOSE ASSETS, AND THAT MOST OF ASSETS IN ANY EVENT HAD BEEN BROUGHT INTO PERU AT A DIFFERENT (LOWER) EXCHANGE RATE PRIOR TO 1969.

8. BROUSSET ENDED BY PROMISING THAT COMMISSION WOULD TAKE NOTE OF USG ILLUSTRATIONS, AND SAID THAT THE COMMISSION WOULD BRING FORTH ADDITIONAL FACTS THAT SHOULD BE TAKEN INTO ACCOUNT WHEN THE USG IS DETERMINING VALUE OF U.S. COMPANY OPERATING IN A FOREIGN COUNTRY.

9. COMMENT: U.S. PRESENTATION CLEARLY INDICATED TO GOP COMMISSION THAT WE DID NOT ACCEPT BOOK VALUE AS BASIS FOR VALUATION AND THAT, INDEED, OTHER WIDELY RECOGNIZED METHODS PRODUCED FAR HIGHER FIGURES. (AS IS PROBABLY OBVIOUS FROM FOREGOING, FIGURES USED WERE CONCOCTED BY U.S. TEAM IN EARLY HOURS OF FRIDAY MORNING BASED ON UNAUDITED RAW DATA SUPPLIED BY MARCONA. IN COURSE OF NEXT ROUND OF TALKS WE MUST BE PREPARED TO SUBSTANTIATE DATA WE USE FULLY.) LATER CONVER-

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SATION WITH CABINET OFFICIALS (SEPTTEL) CONFIRMED GOP'S UNDERSTANDING THAT THEIR BOOK-VALUE FIGURES SIMPLY ARE NOT IN THE BALLPARK AND THEY MUST FIND A PROCEDURE THAT RESULTS IN A FAR HIGHER FIGURE. ON THE OTHER HAND, USG DEMONSTRATED GOOD FAITH BY COMING FORWARD WITH A NEW FIGURE \$20 MILLION BELOW LOWEST AMOUNT PREVIOUSLY DISCUSSED BY MARCONA, AND BY SEEKING TO RECIPROCATATE COMMISSION'S SERIOUS APPROACH TO PROBLEM WHILE MAINTAINING ESSENTIAL ELEMENTS OF OUR POSITION.

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